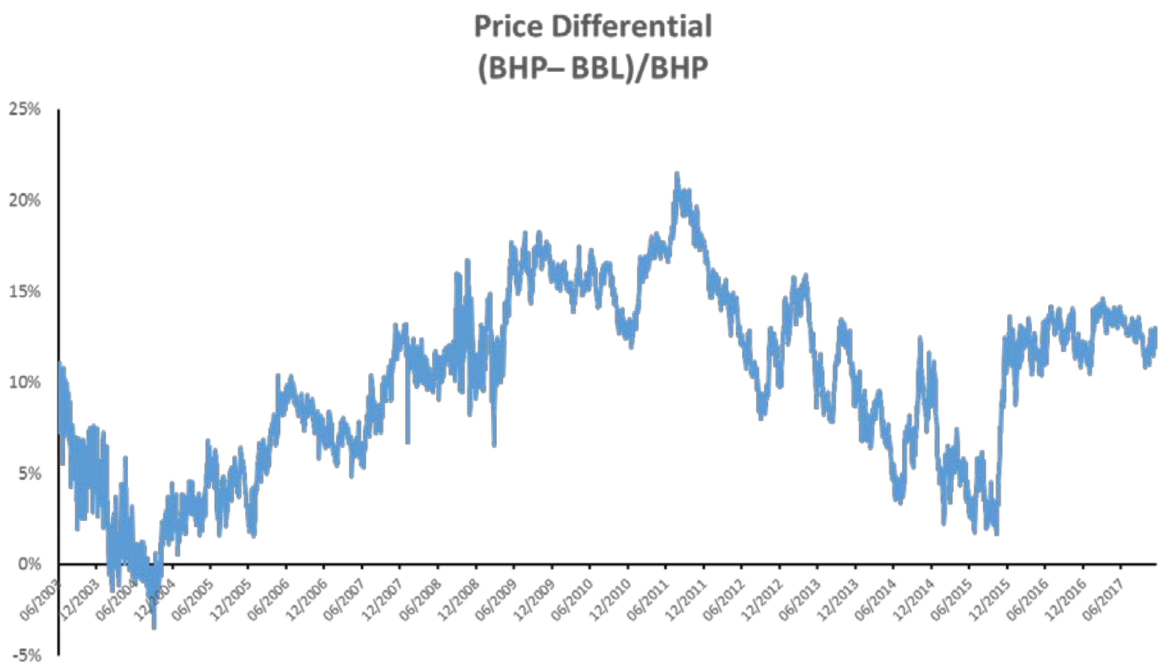
Project Title: The Valuation of Speculative Position-Taking and Imputation Tax Credits within the BHP Billiton Group Dual-Listed Structure

Background

The BHP Billiton Group was created in June 2001 by combining the Australian company BHP Ltd, and the British company Billion Plc, into a dual-listed company structure. The Australian company, BHP Billiton Ltd, is listed on the Australian Securities Exchange, and the British Company, BHP Billiton Plc, is listed on the London Stock Exchange. Under the dual-listing structure, the companies are distinct legal entities with separate share registers, but they are managed as a single economic entity. Shareholders in the two companies have equal economic rights (receive the same cash dividends) and equal voting rights.

However, consistent with the findings of influential research by Rosenthal and Young (1990), Froot and Dabora (1999) and de Jong, Rosenthal and van Dijk (2009) that has examined dual-listed companies, the difference in share prices between the two companies has been persistent and significant from the creation of the structure to the present. Importantly for research purposes, shares in both companies have American depositary receipts (ADRs) traded on them, meaning that in examining these share price differences, non-simultaneity of trading between shares in the two companies and exchange rate conversion do not present methodological problems. The following graph shows the relative pricing of ADRs trading on BHP Billiton Ltd (ticker: BHP) and BHP Billiton Plc (ticker: BBL).



The ADRs over shares in BHP Billiton Ltd have generally traded at a premium to the ADRs overs shares in BHP Billiton Plc, but there has been marked time-variation, with there being a discount of approximately 3% in September 2004 and a premium of over 20% in August 2011. As at December 2017, the premium was over 12%.

Possible explanations

The literature with respect to dual-listed companies provides two central possible explanations for price differences. Firstly, country-specific sentiment shocks and investor speculation may result in shares in one country having a higher price than in the other country. The existence of noise traders and the risk that the price difference may increase in the intermediate term and may not be removed for an unknown long time (see, for example, Shleifer and Vishny (1997)) results in limits to this difference being arbitraged away.

Second, there is expected to be substantial tax-induced investor heterogeneity. For example, Australian resident investors would prefer BHP Billiton Ltd shares in order to receive dividend taxation credits. However, for third-country investors such as US investors, any pricing differences would depend on taxation treaties. Bedi et al (2003) suggest these treaties would make them largely indifferent between investing in BHP Billiton Ltd or BHP Billiton Plc. Froot and Dabora (1999) and de Long et al (2009), while not examining an imputation tax environment, do not find evidence supportive of a tax explanation.

Project

This research project examines country-specific sentiment shocks and investor speculation, as well as tax-based explanations, for the time-varying price difference between the prices of BHP Billiton Ltd and BHP Billiton Plc shares. Country-specific sentiment shocks are tested by examining the comovement of returns with local indices and the association between currency changes and price differences. Taxation explanations are tested by examining ex-dividend drop-offs for both the American depositary receipts and the underlying shares. An analysis of off-market buybacks that have been used to transfer imputation tax credits to Australian investors in BHP Billiton Ltd is also examined. Further, time-variation in the franking account balance is examined as a possible causal factor for the price difference.

In April 2017, the US-based hedge fund Elliot Funds, which together with its associates owned approximately 4.1% of the shares of BHP Billiton Plc, called for the unification of the dual-listed structure into a single Australian-headquartered and Australian-tax-resident listed company. This call is detailed in the dedicated website www.fixingbhp.com. Included in it are claims that '$US9billion has been destroyed through share buybacks made at inflated market prices', and that 'US853million in franking credits (have been) wasted due to an obsolete dual-listed company structure'.

This project brings academic rigour to the examination of the pricing of a company that represents approximately 4% of the total market capitalization of the Australian equities market at a time when its structure, operations, and contribution of Australian taxation revenue are of central policy importance. Its market capitalization, and the involvement of superannuation funds in any activism related to changes to the company structure, makes this issue of substantial importance to the Australian superannuation industry.

Project team

Steve Easton is Foundation Professor of Finance at the University of Newcastle and Sean Pinder is an Associate Professor in the Department of Finance at the University of Melbourne. Both team members have wide industry-engagement experience in the application of financial theory and empirical evidence in assisting market participants in continuing to develop, innovate and evolve Australia's financial markets.

References

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